IN THE

Supreme Court of the United States.

OCTOBER TERM, A. D. 1904.

No. 424.

UNION TRUST COMPANY AND SECURITY WAREHOUSING COMPANY, *vs.* HENRY L. WILSON, TRUSTEE IN BANKRUPTCY OF HARRY L. FLANDERS.	On Certificate from the Circuit Court of Appeals for the Seventh Circuit.

STATEMENT.

The certificate in this case contains the following recital of facts:

"Harry L. Flanders was for some years prior to October 27th, 1903, a wholesale dealer in leather, occupying under lease a store on Lake street in Chicago, Illinois, 18 or 20 feet wide and running back 132 feet to an alley. At the rear of the premises on the first floor is a platform which extended to the alley and was used for shipping goods. The front portion of the first floor was used as an office and was partitioned off about 25 feet from the front of the premises. In this partition was a door through which access was had to what is known as the store room, which occupied the balance of that floor.

The Security Warehousing Company is a corporation

organized under the laws of New York, with power to transact, and it has for more than two years last past been engaged in transacting, the business of a warehousing company on a large scale throughout the United States. As a rule, except in a few cases, it owns no warehouse of its own and maintains no warehouse building wherein it stores the property of sundry persons, but its general method of warehousing is the leasing from persons desiring to obtain its receipts, of all or a portion of a building or the leasing of vacant land from such persons, and the placing thereon of property and issuing receipts therefor substantially in the manner hereinafter stated.

In April, 1903, a written agreement was entered into by Flanders and the Warehousing Company, providing for the receipt by the Warehousing Company from Flanders of personal property for storage, and the issuance of storage receipts therefor, and further providing, among other things, (1) that Flanders should indemnify and hold harmless the Warehousing Company against the claim of any holder of storage receipts for property stored therein on account of the loss, damage or destruction of the property stored, unless it should be held due to acts of dishonesty on the part of the Warehousing Company's agents, servants or employes, whether the storage receipts be in the hands of the original owner or any one else; and

(2) Flanders also agreed to pay the Warehousing Company as compensation for the storing of said property, and issuing its storage receipts, as follows: $20.00 per month for property of a market value of $10,000 or less, and for all property in excess of ten thonsand dollars of market value, one dollar ($1.00) per month per thousand dollars of market value, and in addition thereto, the expenses, cost of inventories and inspections, incurred by the Warehousing Company, and an amount equal to the salary paid by the Warehousing Company to any custodian placed by it in charge of said property and premises.

Thereupon Flanders partitioned off the rear of the basement and a portion of the east side thereof, mak-

ing an L-shaped enclosure. The partition consisted of wooden boards closely fitted together running perpendicularly from the floor to the ceiling. There were three large sliding doors about six feet wide in this partition, which opened by sliding horizontally on an iron rod or strip at the top. The following is a plan of the basement after the construction of this enclosure:

(See diagram page 3 of record.)

On May 1st, 1903, Flanders executed a written lease of the space thus enclosed to the Warehousing Company, for a period of one year, and so long thereafter as property should remain therein, for which receipts of said Warehousing Company had been issued and were in force, at a nominal rental. In said lease Flanders agreed to give the Warehousing Company easy and convenient access at all times to said leased premises through the balance of his said premises.

Flanders immediately gave to the Warehousing Company a key to the front (street) door of said first floor, which key at all times thereafter remained in the possession of the Warehousing Company; by use of such key said Company was enabled to reach such enclosed premises at all times of day or night from May 1st, 1903.

Immediately after the execution of the lease there was placed upon each of these three doors a padlock with the name of the Warehousing Company stamped or indented upon it, and from that time these padlocks and doors were continually locked, except when opened by the agents of the Warehousing Company for the purpose of inspecting the goods placed therein or delivering portions thereof upon the receipts hereinafter mentioned. All the keys to said locks were always in the possession of the agents for the Warehousing Company, who alone had access into said enclosed space.

The Warehousing Company caused to be placed upon the outside of this wooden partition two signs, which were at the points designated on the above plat by the word "sign," and recited in large type that the

premises were leased and occupied by the Warehousing Company as a public warehouseman. One of these signs (that opposite the elevator) was readable by the natural light coming through the box window and down the elevator shaft (when the elevator was down) by any one alighting from the elevator. By means of the artificial and natural light in the basement the other sign was also readable. These signs since placed there have *remained upon said* partition.

A freight elevator in said building descended into said basement at the point marked "Elevator" on said plat and was the only means of access to the basement. This elevator was an ordinary freight elevator, the shaft being about six feet square and enclosed on the first floor. Access to said elevator from the first floor was had by means of a sliding wooden door, to which there was a lock and key. When this door was locked, access to the elevator could not be had. The Storage Company did not have a key to this door, but the key was kept on a nail, convenient for use. The only natural light in the basement was such daylight as came down the elevator shaft and through the two windows in the rear, which were immediately north of said elevator space in the basement and west of door "A" in said plat. These windows were about 6 by 2 feet and opened out over said shipping platform. One of them opened into the enclosure and the other into the uninclosed portion of the basement.

Since the making of said lease no one without the consent and co-operation of the Warehousing Company could get into said enclosure or acquire physical control or possession of the goods stored therein without breaking through the said partition or doors or windows opening into said enclosure.

From time to time since said enclosure was completed certain bundles of leather belonging to Flanders were placed therein, and thereupon the Warehousing Company gave Flanders receipts in the following form:

Storage Receipt of
SECURITY WAREHOUSING COMPANY.
General Offices 346 Broadway, New York.
District Offices: 540 Rookery, 217 La Salle St., Chicago.

Date, May 11, 1903. Issued at Chicago, Illinois.

The Security Warehousing Company certifies that it has received on storage in premises No. 194, located at Chicago, Illinois, 204 Lake Street, Basement, subject to the order of H L Flanders & Company, Chicago, Illinois, the following commodity, viz.: Thirty five (35) Bundles leather, said to be Flexible Splits "H", and measure seventy two hundred and fifty-four (7254) square feet. Pile No. 199. Located in Section No. 15. To be known as Lot #140.

Said commodity to be retained on storage and delivered only upon surrender of this receipt properly endorsed and payment of all charges thereon. Provided, however, if such commodity or any part of it remaining undelivered be uncalled for within one year from the date hereof, the Security Warehousing Company may at its option, upon giving three days notice of its election so to do store the whole or the undelivered part of such commodity elsewhere at the expense of whomsoever may then be entitled to same. The Security Warehousing Company in no event shall be under any liability for errors or mistakes committed in the inspection of such commodity unless claim in writing therefor be made upon it within one year from the date hereof, and the said Company shall not be liable for the destruction of or damages to such commodity by fire, water or from inherent qualities of the property.

Storage and Charges as per contract.

SECURITY WAREHOUSING COMPANY,
By ALEX GRIEG,
President.

All of the receipts outstanding were issued prior to October 29th, 1903. Each of said receipts covered

a separate lot of leather located in said enclosed space at the time of the issuance thereof, and contained a lot number and distinguishing mark corresponding with those upon the lot of leather for which it was issued.

At the time each of said lots of leather was placed in said enclosure there was also placed thereon a printed card, reciting that such property was in the possession of the Warehousing Company and containing the lot number and distinguishing mark which were upon the receipt issued for such lot. These cards so remained on said lots during all the time the lots were in said enclosure, and one going into some portions of said enclosure, by the natural light from said window, and by the use of artificial light in other portions thereof, would at all times have been able to see said cards and the printing thereon, and no one could have well handled any of said leather without observing the cards attached thereto and the printing thereon.

Each of the receipts so issued by said Warehousing Company was, about its date and prior to October 29, 1903, endorsed and turned over by Flanders to the Union Trust Company of Chicago, as collateral security for loans then made by it to him, for which it took his notes. The Trust Company loaned said moneys and took as security therefor said receipts in the regular course of its business. When Flanders desired to take leather out of the enclosure he would pay to the Trust Company a certain amount of money on account of the note or notes secured by the receipt covering such leather, and the Trust Company would deliver said receipt to Flanders, taking from him an agreement to return the same. Flanders would then request the Warehousing Company to send its representative to the premises; the representative would unlock the enclosure; Flanders' employes would remove the leather; the representative would endorse on the receipt the amount of leather withdrawn and Flanders would return the receipt so endorsed to the Trust Company, except when all the leather covered

by the receipt was so delivered, when the receipt would be surrendered to, and be cancelled by, the Warehousing Company.

None of the leather placed in these enclosures was released or taken out in any other way or under any other circumstances than as above. Flanders did not have access to said leather or said enclosure, and no leather was placed in said enclosure for which receipts were not issued by the Warehousing Company as aforesaid. The space within such enclosure was not used for any purpose except the storage of the leather for which the Warehousing Company issued its receipts as aforesaid. Periodically and on an average of about once a week an agent of the Warehousing Company visited the enclosed premises for the purpose of inspecting the same and ascertaining whether there had been any disturbance of the property or enclosure.

Flanders never deposited all of his stock of any one kind of leather in the enclosure. He always retained in the store room at least a sample or samples, and sometimes sold by sample, taking the leather from the enclosure for delivery to the purchaser by the procedure above described.

The Trust Company still holds all said receipts. The loans so made by it to Flanders and still remaining unpaid, aggregate $54,449.09, represented by notes of Flanders.

The Warehousing Company had no office on the premises of Flanders, its only office in the City of Chicago being approximately half a mile from these premises; nor did the Warehousing Company have any representative permanently on the premises of Flanders; nor were there any signs upon the exterior of said building; nor did the name of the Warehousing Company appear in any way or in any place on said premises, except upon the signs in the basement above described. No leather was ever placed in said enclosure except leather belonging to Flanders.

On October 29th, 1903, in the District Court of the United States for the Northern District of Illinois,

Flanders was adjudged a bankrupt, and Henry L. Wilson, being appointed his trustee in bankruptcy, filed a bill alleging that said storage arrangement was fraudulent, and claiming the leather then within the enclosure upon the ground that it always remained in the possession and control of Flanders, and by reason thereof came into the possession of said trustee, and praying that the receipts be adjudged void, and for a receiver, etc., and from a decree in such suit an appeal was perfected to this court."

The certificate requests the instruction of this court upon the following questions of law:

"1. Whether, upon the facts above recited, the receipts issued by the Warehousing Company are to be deemed valid warehouse receipts, so that their endorsement by Flanders to the Trust Company, as security for loans, constituted a pledge or pledges to the Trust Company of the leather covered by such receipts, which would be valid against attaching creditors.

2. Whether, if the receipts are not to be deemed valid as *warehouse receipts,* upon the facts above recited, the transactions are to be regarded as constituting pledges of such leather by Flanders to the Trust Company, which would be valid as against attaching creditors.

3. If there was no pledge, whether the Trust Company, under the facts above recited, acquired an equitable lien upon such leather that is superior to the title thereto of the trustee in bankruptcy."

As an affirmative answer to the first question would render the consideration of the second and third unnecessary, and to the second would dispense with a response to the third, this brief will discuss them in the order, in which they are stated by the Circuit Court of Appeals.

BRIEF OF ARGUMENT.

I.

THE RECEIPTS IN QUESTION ARE VALID WAREHOUSE RECEIPTS, AND THEIR ENDORSEMENT CONSTITUTED A VALID PLEDGE.

The first of the certified questions results from the contention of appellee in the Circuit Court of Appeals, that the law should not sanction the method of warehousing here disclosed.

The certificate states that the Security Warehousing Company is "engaged in transacting the business of a warehousing company on a large scale throughout the United States. As a rule, except in a few cases, it owns no warehouse of its own and maintains no warehouse building wherein it stores the property of sundry persons, but its general method of warehousing is the leasing from persons desiring to obtain its receipts, of all or a portion of a building or the leasing of vacant land from such persons, and the placing thereon of property and issuing receipts therefor substantially in the manner hereinafter stated."

Indeed, it is a matter of such general knowledge, that this court may well take judicial notice that sundry like companies are engaged in the same kind of warehousing, and that warehouse receipts issued in the manner disclosed by this record have extensively become instruments of commerce, and are the basis of transactions upon at least one commercial exchange in this country.

It may be aptly styled a new system of warehousing. Its origin is to be found in the requirements of modern commerce. It results from the commendable aim of our business men to cheapen the cost of production and distribution, which has given rise to the commercial exchange, the clearing house of the banks and many other like trade-facilities of recent date.

The principle of evolution finds exemplification in the business of warehousing. Take, for illustration, the warehousing of grain. The original theory of warehousing required the return to the depositor of the identical grain deposited, either as grain or flour. But it soon became impracticable to keep each person's grain by itself. Only the equivalent in quantity of his grain could well be returned to the depositor. At first the law declared that, where grain stored in a warehouse was not kept separate from that of others, the relation between the depositor and the warehouseman was only that of debtor and creditor.

This was attended with too many inconveniences to withstand the demands of commerce. As the trade in grain grew, the law was compelled to recognize "bulk" warehousing in grain, and permit the grain of different depositors to be mixed together without destroying the title of each to his undivided part of the mass. While this change in the law was accomplished in Illinois and some states through legislation, in Iowa (*Sexton* v. *Graham*, 53 Iowa, 181) and many other states it resulted without statute, and because the courts felt under the necessity of conforming the law to the requirements of modern commerce.

Another change in the business of warehousing is

presented by the method disclosed in the certificate. Commerce has found that many articles of trade—iron, coal, lumber, etc.—could not, because of the expense of removal, be carried to a central or general warehouse for storage, but must be warehoused, if at all, at or near the point of production or manufacture. Especially in the South, where the amount of capital available for business is limited, has it been found helpful to manufacturers to resort to this method of warehousing. Thereby pig iron and other raw and manufactured products are, for commercial purposes, turned into storage warrants, by the use of which available capital is more readily secured, and thus manufactories are operated more continuously and labor is more steadily employed.

Again, many towns where factories are located are too small to sustain a general warehouse. The removal of many articles of manufacture from such a town to a general warehouse in a larger place is so expensive, relative to the value of the goods and the profits of manufacture, as to preclude their being warehoused at all in that way.

Such are the business necessities that have given rise to this new system of warehousing. To withhold from it legal sanction is to place at a disadvantage the manufacturer in a small town and the merchant or manufacturer of bulky products, who seek to utilize their property to increase their working capital, as others differently circumstanced do. So, the question here is—as it was in the case of bulk warehousing of grain—whether the law will obstruct, or conform to, the requirements of modern commerce.

This new system asks of the courts no *new* law. It only seeks to have applied to its transactions the same law, that has for many years been applied to other analogous cases.

Doubtless it is competent for a state, within constitutional limits, to regulate warehousing within its borders, and declare what shall constitute a warehouse and what a warehouse receipt. The State of Illinois, however, has not, as respects this kind of warehousing, seen fit to adopt any statute imposing any restrictions.

Article XIII, Sec. 1 of the Illinois Constitution of 1870 provides:

"All elevators or store houses where grain or other property is stored for compensation, whether the property stored be kept separate or not, are declared to be public warehouses."

Other sections of the same article deal with the warehousing of grain and impose upon the legislature the duty of passing laws for the inspection of grain and for the protection of producers and shippers of grain.

In compliance with this mandate the legislature passed a statute, the 1st, 2nd and 24th clauses of which are as follows (R. S., Ill., Chapter 114):

Sec. 1. "Public warehouses, as defined in article 13 of the constitution of this state, shall be divided into three classes, to be designated as classes A, B and C, respectively."

Sec. 2. "Public warehouses of class A shall embrace all warehouses, elevators and granaries in which grain is stored in bulk, and in which the grain of different owners is mixed together, or in which grain is stored in such a manner that the identity of different lots or parcels cannot be accurately preserved, such

warehouses, elevators or granaries being located in cities having not less than 100,000 inhabitants. Public warehouses of class B shall embrace all other warehouses, elevators or granaries in which grain is stored in bulk, and in which the grain of different owners is mixed together. Public warehouses of class C shall embrace all other warehouses or places where property of any kind is stored for a consideration."

Sec. 24. "Warehouse receipts for property stored in any class of public warehouses, as herein described, shall be transferable by the indorsement of the party to whose order such receipt may be issued, and such indorsement shall be deemed a valid transfer of the property represented by such receipt, and may be made either in blank or to the order of another. All warehouse receipts for property stored in public warehouses of class C shall distinctly state on their face the brand or distinguishing marks upon such property."

Most of the other sections of the act formulate an elaborate system of storing grain in bulk, and require it to be inspected as it goes in and out of warehouses. The remaining sections aim to secure honest warehousing. None are pertinent to the questions arising here.

Section 24, above quoted, is, as respects the transferability of the receipt, but declaratory of the common law, as will be manifest from the authorities hereinafter cited.

The enclosure in the case at bar falls within this constitutional definition of a public warehouse; for it was a place where property was stored for compensation. (Here see *Union Trust Co.* v. *Trumbull,* 137 Ill., 146, hereinafter referred to.) In any event, there is in these provisions no state prohibition of, nor restriction upon, this method of warehousing.

As the receipts in question were issued, and cover property, in Illinois, any authoritative decision of its courts would doubtless control. (*Hervey* v. *Rhode Island Works*, 93 U. S., 664.) But there are no such decisions.

If, therefore, the enclosure, in which the property in question was located, is to be adjudged not a warehouse, and the receipts issued therefor not warehouse receipts, it must be because of some inhibition in the common or general law. Is there, then, in that law, anything that requires this court to deny to these receipts the character of warehouse receipts?

By the law of Illinois, as by the law generally, the transfer of personal property, either absolutely or by way of security, must, as against subsequent purchasers or lien holders, be accompanied by a change of possession, except in the case of a chattel mortgage where, by statute, recording is made a substitute. In this respect there is no distinction between a sale or pledge without, and one made through, the intervention of a bailee (warehouseman).

Because of this rule of law, it is essential to the legality of every kind of warehousing, and of all receipts, that such bailee should have the possession and control of the property covered by the receipts.

The only substantial difference between the kind of warehousing under consideration and ordinary warehousing is, that in the former the warehouseman, instead of having one building in which is stored the goods of all his depositors, may have numerous rooms or premises in a single city or town, and these are so located that, as a rule, only one depositor resorts

to them. But there is no legal reason for requiring a warehouseman to have all his rooms under one roof, or all the property stored by him in one building. Would not all his rooms, although located at different places, be deemed in contemplation of law, as his warehouse? Other legal requirements being met, of what legal consequence is it that his warehousing space is thus divided?

The only objection urged against this system of warehousing is the argument of false credit or secret lien; but this applies here with no greater force than in the case of a sale, or direct pledge, or unrecorded chattel mortgage. In such cases an open and visible change of possession is deemed sufficient. Why is this not so also in this case of warehousing?

In considering the question, what constitutes a change of posession, this distinction should be noted. As between the vendor and vendee, anything indicating the intention of the parties that the former should release the control of the property and the latter assume it, is sufficient to pass title, make the purchase price due, or locate the loss in case of destruction by fire. But, as against levying creditors, subsequent encumbrancers and purchasers, the law not only requires a change of possession, but that it be open and visible.

What constitutes such a change of possession, as between the parties last named, is also sufficient in law as between the pledgee or chattel mortgagee, and subsequent purchasers, or levying creditors, of his pledgor or mortgagor.

So, the reason being the same, the extent to which a

change of possession is required, must be the same, when it arises between a warehouseman and his receipt holders on the one side, and purchasers from, or levying creditors of, the bailor on the other side.

Hence, authorities holding the change of possession sufficient in the case of a sale, pledge or chattel mortgage are equally in point in determining, whether the facts shown by this certificate constitute a sufficient change of possession as against attaching creditors of the bankrupt.

The certificate shows that the Warehousing Company acquired by lease from the bankrupt the right to the possession, and enjoyed exclusive possession, of an enclosed room, and the right of access, and, by the possession of a key to the front door, had actual access, from the street to its storage enclosure. The certificate also states that the doors of this enclosed room were continuously locked, and the key thereof was continuously in the possession of the Warehousing Company, and that "no one without the consent and co-operation of the Warehousing Company could get into said enclosure or acquire physical control or possession of the goods stored therein without breaking through the said partition or doors or windows opening into said enclosure." In other words, such was the control of the Warehousing Company, that no one could, against its will, get into the enclosure or to the goods stored therein without an act of violence.

"Flanders did not have access to said leather or said enclosure, and no leather was placed in said enclosure, for which receipts were not issued by the Warehousing Company as aforesaid. The

space within such enclosure was not used for any purpose except the storage of the leather for which the Warehousing Company issued its receipts as aforesaid." *Thus the Warehousing Company at all times had the exclusive possession and control of the enclosure and the property within it.*

Again, there was fastened upon the outside of this enclosure at least one sign, which "recited in large type that the premises were leased and occupied by the Warehousing Company as a public warehouseman." This sign was readable without artificial light by anyone alighting from the elevator—the only means of access into the basement.

On each lot of leather within the enclosure there was placed a printed card reciting that the property was in the possession of the Warehousing Company. One going into said enclosure could, by natural light, see some of these cards. "No one could have well handled any of said leather without observing the cards attached thereto and the printing thereon."

In other words, the steps taken were ample to notify anyone seeing the property or the premises, in whose possession and control they were.

The real question then is, whether the placing of property in a room, leased to, and kept locked by, a vendee or pledgee or warehouseman, accompanied by a continuous display of signs and placards plainly indicating the vendee's, pledgee's or warehouseman's interest, constitutes a sufficient change of possession to make the transaction valid. It is believed that the following cases amply warrant an affirmative answer to this question.

Hatch v. *Oil Company*, 100 U. S., 124:

In that case a firm agreed to manufacture and sell staves to the Oil Company, and leased to that company a tract of land adjoining the firm's mill, upon which the staves were piled as manufactured and counted by an agent of the Oil Company. Before anything else had been done in the way of changing possession, creditors of the manufacturers levied execution on the staves and contended that, as against them, there had been "no actual or continued change of possession" within the meaning of the statutes of Michigan, where the property was located. But the court awarded the staves to the Oil Company, saying:

"Actual delivery of the staves having been proved, it is not necessary to make any reply to the defense set up under the State statute in respect to the sale of goods unaccompanied by a change of possession."

Sumner v. *Hamlet*, 12 Pick., 76:

In that case a manufacturer of flannel obtained a loan from defendant upon the security of forty-five pieces of cloth, and it was arranged that these pieces should be placed in charge of one Guild, foreman of the factory. This foreman selected forty-five pieces of cloth, and they were set apart and marked with the defendant's initials, but were not removed from the factory. Being subsequently levied upon by a creditor of the manufacturer, Chief Justice Shaw upheld the pledge, saying (p. 82):

"We are also of opinion, that the *lien* thus created was maintained by the possession of Guild. Whatever was the nature of his general relation to the proprietors of the manufactory, in this particular transaction he was constituted the special agent of the de-

fendant, for the purpose of keeping possession for him, although in other respects the servant of Stanley & Co. * * * To constitute such special possession, it was not necessary that the goods should be removed from the premises of the former owners; it was sufficient that they were so far in the custody of the special bailee, that he could at all times have the legal control of them, and give notice of the lien to any purchaser and attaching creditor, and remove the goods if such removal should be necessary for the safety of the principal."

First National Bank v. *Pennsylvania Trust Company*, 124 Fed., 968; 60 C. C. A., 100:

There a steel company borrowed money from a bank, and executed to it a bill of sale of certain billets, which were permitted to remain on the premises of the company. The billets were marked by a sign posted on the several piles, reciting that they were the property of the bank. The steel company was then adjudged a bankrupt, and its trustee resisted the claim of the bank to a lien upon the billets; but the Circuit Court of Appeals of the Third Circuit upheld the lien saying (p. 969):

"It cannot be disputed that on the 30th day of August, 1901, when the bank discounted the note of the steel company, and took the bill of sale of the billets, it acquired a good and valid title thereto as between itself and the steel company. To complete its title or lien as against creditors and strangers, the bank was not obliged to take the billets into actual possession; it was sufficient to give notice of their lien or change of ownership. This they did by posting on the billets, which were in distinct and separate piles, the sign to which reference has been made, so that on August 30, 1901, the title of the bank or its right to a lien on the billets was good as against all of the world."

Bank of Rome v. *Haselton,* 83 Tenn., 216:

In that case material belonging to an iron company was stored in a warehouse forming a part of its plant, which was leased to one Lowe, but for which he paid no rent. Other material consisting of pig iron, etc., was stored outside of this warehouse in yards around the iron company's works. Thereupon Lowe issued to the iron company warehouse receipts for the property thus stored, and the latter delivered them to various parties to secure loans. Subsequently attaching creditors levied upon the property, and insisted that the receipts were invalid, because the property had never been in the possession of Lowe, but remained with the iron company. But the possession of Lowe was held sufficient, the court saying (p. 247):

"In short, the actual possession was in Lowe; the property was in the warehouse or on the yard when the receipts were given, and they are not invalid for the want of possession by the warehouseman and consequent authority to issue them."

Sharp, Assignee, v. *Philadelphia Warehouse Co.,* 9 Reporter, 572:

There a dealer of goat skins leased the cellar of his store to the Warehousing Company at a nominal rent, and merchandise of such dealer was placed in this cellar, and on the security thereof loans were made by the company to this dealer, who subsequently was adjudged a bankrupt, and a bill was filed by his assignee in the federal circuit court at Philadelphia, seeking to adjudge the pledge fraudulent and void, as against creditors of the bankrupt, upon the ground that there had been "no change of possession,

although the goods were capable of actual delivery," but the court (Butler, J.), upheld the pledge, saying:

"As respects the goods placed in the cellar, we see no room for controversy. Leasing the cellar and removing the goods thereto, constituted a sufficient delivery to satisfy the requirements of law."

Kentucky Furnace Co. v. *City Bank,* 25 Ky. Law Rep., 28:

That case affirms the validity of warehouse receipts issued under circumstances similar to those at bar, the Court of Appeals saying:

"The Kentucky Furnace Co. leased to J. P. Holt a part of its ground and then placed upon the ground so leased its pig iron, and Holt issued to it warehouse receipts therefor. These warehouse receipts it pledged to appellee for money loaned. The pig iron was stacked on the ground and was marked by Holt with chalk marks 'C. N. B.', after the pledge of the certificates, to show that it belong to appellee, the City National Bank. * * * The arrangement was in perfect good faith; the property on which the bank held a lien was separated and marked, and the lien of the bank was recognized by the furnace company. After all this, on August 6, 1900, the furnace company became bankrupt, and appellant was elected trustee of the bankrupt estate. * * * Appellant, after this, brought the suit before us, alleging that he had demanded the possession of the property from the bank that he might administer upon it as part of the bankrupt estate, and praying judgment against it for the property. * * *

This was a valid pledge, and the circuit court properly enforced it."

Fidelity Co. v. *Roanoke Iron Co.,* 81 Fed., 439:

In that case the iron company borrowed money from a warehouse company upon the security of certain iron.

"The warehouse company therefore leased parcels of land from the iron company next to the cast house of the iron company, and on this the iron was stored; the warehouse company having an agent specially designated in charge of their iron, and signs being put up on the premises on which appeared 'Storage Yard Philadelphia Warehouse Company.' * * *

The first question is, was this arrangement between the iron company and the warehouse company a valid pledge? * * * The question must be answered in the affirmative."

American Warrant Co. v. *German,* 126 Ala., 194.

There the court in sustaining the validity of a pledge against the claim of a subsequent pledgee of the same pledgor, said (p. 239):

"In this case it is clearly proven that under the agreement of pledge between the furnace company acting by its president and Verchot, a particular spot of ground belonging to that company and located apart from its own iron yards was tendered by the president and accepted by Verchot for his use and that a quantity of iron was placed thereon, piled in 100 ton lots and marked with paint with Verchot's initials."

Dunn v. *Train,* 125 Fed., 221; 60 C. C. A., 113:

There the plaintiff loaned money to a paper company and took as security certain paper, which remained at the mill of the paper company in the custody of an agent appointed for that purpose. The Circuit Court of Appeals of the First Circuit upheld the pledge, saying (italics ours):

"This case must therefore turn upon the question of delivery and acceptance, or, in other words, upon change of possession. * * *

It being a question of intention, and a question whether the change in the situation of the property was

such as to be *notice of a change of possession*, it was, under the circumstances, largely a question of fact, to be determined under the rules of law. * * *

It was further found as fact that from the said 31st day of August the paper company for a time delivered to Mr. Kline, under this arrangement, all the finished product of the mill, the place of such deposit being accessible from other portions of the mill; that paper thus deposited remained where it was deposited in the mill, apart by itself, not confused with any other paper, until December 30, 1895, at which time the paper company had constructed a new storehouse, and thereupon the paper which had been already delivered and deposited in the basement and shipping room of the mill, as above stated, was transferred to the new storehouse, and remained under the care of Gedney, who had been appointed the agent of Train, Smith & Co. [the creditors], where it remained apart from all other paper until replevied. * * *

Nor is there any absolute rule of law which requires property pledged to be removed from the premises of the pledgor. *It is enough if the facts sufficiently show that the goods are actually set apart in the keeping of the special bailee, with authority to notify third persons that they are held in pledge,* and to remove the goods, if found necessary for the safety of his principal."

Allen v. *Hollander,* 128 Fed., 159.

There the debtor, a dealer in carriages, undertook to transfer certain carriages to a creditor to be sold by him, the proceeds to be applied on the indebtedness. The carriages were delivered to an agent of the creditor, who removed them *into a separate room in the debtor's warehouse,* where they were tagged with the creditor's name and there left to be sold by his agent, and the pledge was upheld.

Other like cases might be cited, but the foregoing

are thought sufficient to show that, under the rule in transfers of property, the change of possession in the case at bar was a sufficiently open and visible one. All that the authorities require is such change as shall give notice to third parties. Under this certificate it can hardly be contended that the steps taken were not ample to notify anyone seeing the property that it was in the possession of the Warehousing Company.

Were, then, the receipts of such a character that their endorsement and delivery were tantamount to the delivery of the property itself?

It was clearly the purpose of that company to assume, and of Flanders to have it assume, the position and responsibility of a warehouseman. When Flanders borrowed the money from the Trust Company, it was the clear intention of both these parties, that the receipts should be regarded as symbols of the property and their delivery should constitute a valid pledge. Why, then, should not the law give it this effect?

This question would seem to find an affirmative answer in the following cases:

Gibson v. *Stevens*, 8 How., 383.

There a firm bought 350 barrels of pork and 200 barrels of flour, which then were in warehouses of the two sellers, and there remained until seized as hereinafter stated. This firm then borrowed money from Gibson, and delivered to him as security, after endorsing upon the back of each an order for delivery to him or his order, certain documents issued by these sellers and reciting that they held the property subject to the buyer's orders. The sellers do not ap-

pear to have been warehousemen. Subsequently creditors of the firm levied on the property in controversy, and contended that the delivery of the documents did not constitute a pledge, because (1) the documents did "not amount to warehouse receipts"; and (2) there being no statute in New York nor Indiana making their transfer tantamount to the delivery of property, they could not be accorded that effect. But this court, through the Chief Justice, upheld the pledge, saying:

"The transaction, therefore, being in the usual course of trade, and free from all suspicion of bad faith on the part of the plaintiff [Gibson], the question to be decided is, what was the legal effect of the indorsement and delivery of the warehouse documents, in consideration of the advance of money he then made to McQueen & McKay? In the opinion of the court, it transferred to him the legal title and constructive possession of the property; and the warehousemen from the time of this transfer became his bailees, and held the pork and flour for him. The delivery of the evidences of title and the orders indorsed upon them was equivalent, in the then situation of the property, to the delivery of the property itself.

This mode of transfer and delivery has been sanctioned in analogous cases by the courts of justice in England and this country, and is absolutely necessary for the purposes of commerce. * * *

The indorsement of the delivery order upon these evidences of his title, like the indorsement upon a bill of lading, sufficiently manifests the intention of the parties that the title and possession should pass to Gibson. And when that intention is evident from the language of the written instruments and the nature and character of the contract, it is the duty of the court to carry it into execution without embarrassing it with needless formalities. * * *

Nor, as respects the legal title, can there be any distinction between the advance made by Gibson, and the

case of an actual purchaser. To the extent of his advances he is a purchaser, and the legal title was conveyed to him to protect his advances."

In a note to *Lickbarrow* v. *Mason,* Smith's Leading Cas., 7th Am. Ed., Vol. 1, Part 2, p. 1197, it is said:

"The exigencies of trade have called a class of instruments into being, which are substantially acknowledgments by public or *private* agents that they have received merchandise, and from whom or on whose account, and usage has made the possession of such documents equivalent to the possession of the property itself. Thus warrants or receipts are habitually issued for the merchandise deposited in the various warehouses in England; and * * * a sale attended by the transfer of such an instrument, is as effectual as if the property were handed over to the purchaser."

Northrop v. *First National Bank,* 27 Ill. App., 527.

There a receipt issued by one, not a warehouseman, and providing that the property was "deliverable only on surrender of this receipt," was pledged for a loan, and the pledgee recovered in an action of replevin, the Appellate Court saying:

"The *quasi* negotiable character of warehouse receipts was judicially recognized long before the act of the legislature of this state for the regulation of public warehouses was passed. Prior to that time the principle applied by the courts was, that the delivery of warehouse receipts is a symbolic delivery of the property itself, and that it has the same effect as the delivery of the property and can have no greater, and that a transfer of the warehouse receipt, by the person in possession of it, gives no higher title than would the transfer of the property by the same person. * * *

That such is the rule adopted in this State, and that warehouse receipts issued by private agents or by

warehousemen, other than those described as public warehousemen, are placed on the same footing as bills of lading, in respect to their *quasi* negotiable character, we have no reason to doubt."

In a subsequent case, decided in 1897,

Montgomery Ward & Co. v. *Am. Trust & Sav. Bank*, 71 Ill. App., 20,

the same court decided the same way.

These decisions, while not authoritative, are entitled to consideration as showing what the lower courts in Illinois regard as its law on the subject under consideration.

Millhiser Mfg. Co. v. *Gallego Mills Co.*, 101 Va., 579.

There a corporation, engaged in milling flour, also maintained a warehouse, and issued certain warehouse receipts upon grain in its warehouse, without causing itself to be licensed pursuant to a statute of Virginia providing for the licensing of warehouses, and (in language not unlike Sec. 24 of the Illinois Warehouse Act above quoted) that warehouse receipts issued by persons keeping a *licensed* warehouse should be transferable by endorsement, and the assignee of such receipt should be deemed the owner of the property, so far as to give effect to a sale or pledge to him. In a contest for priority between the holders of these receipts and other lien holders the court said:

"The fact that the Gallego Mills Co. did not happen to store in its warehouse the goods of other merchants and manufacturers, but stored alone, as seems to have been the case, the products of the business conducted by it as a milling concern, which had been sold or pledged and transferred both as to title and possession

is, as we think, wholly immaterial, and can have no bearing upon the right of the holders of the warehouse receipts for the flour in question to be delivered only on the surrender of the receipt. * * *

A place adapted to the reception and storage of goods and merchandise is a warehouse at common law. Bouvier's L. D. 1211. * * *

Having considered the nature and effect of the warehouse receipts and elevator certificates involved in this case and reached the conclusion that they, like a bill of lading, at common law, represent the goods therein, and that the transfer of the ownership as well as the right of possession is made as effectually by their transfer and delivery as it can be by a physical delivery of the goods, we are brought directly to the question whether or not Chapter 82 of the Code abrogates the common law with respect to such receipts or certificates and invalidates them and all of like character where not issued by a licensed warehouse whose owner or proprietor has complied with the statute. * * *

Our conclusion upon this branch of the case is, that the holders of the warehouse receipts and elevator certificates took by the transfer and delivery of the receipts or certificates the legal right to and possession of the property they respectfully represent, the Callego Mills Co. retaining but an equitable interest in the surplus, if any remain after satisfying the claims of such holders. * * *

We regard the statute, Chap. 82 of the Code, *supra*, as merely declaratory of the common law as applied to *licensed* warehouses under that statute, adding that such provisions as were deemed essential for the better protection of the holders of such receipts, not a sentence or a word even of negation of the common law being contained in the statute."

See, also,

Rice v. *Cutler*, 17 Wis., 362.

Under the authority of these cases the endorsement and delivery of the warehouse receipts in ques-

tion constituted pledges, even if the Warehousing Company should not be deemed a *public* warehouseman under the Illinois statute.

But *Union Trust Company* v. *Trumbull*, 137 Ill., 146, (decided in 1891 and hereafter more fully set out), supports the position that this Warehousing Company is a public warehouseman under that statute. In that case the endorsement of receipts, issued by a warehousing company doing a similar business, was held not to create a legal pledge, but this was expressly put upon the grounds (1) that the storage company in that case had not taken or maintained adequate possession, and (2) that it had not complied with the Illinois warehouse act (which relates only to public warehouses), in that the wool covered by each receipt could not be identified by its receipt. The necessary inference is that, but for these two defects, the receipts, when endorsed as security, would have been valid pledges. Thus the court clearly contemplated that the storage company was within that statute—that is, a public warehouseman.

Without referring further to the numerous cases, they easily justify the proposition, that receipts issued by one engaged in the business of storing, for a compensation, goods not his own, whether a statutory (or public), or only a private, warehouseman, are such warehouse receipts, that their endorsement and delivery are tantamount to delivery of the property itself, and create a legal pledge.

It is therefore insisted that the first question certified should be answered in the affirmative.

II.

IF THE FIRST QUESTION IS ANSWERED IN THE NEGATIVE, STILL THE TRANSACTIONS CONSTITUTED A VALID PLEDGE BY FLANDERS TO THE TRUST COMPANY.

If Flanders had proposed directly to the Trust Company that, to secure the loan, he would lease to it this enclosure, and put therein this property, give the Trust Company the only key to its door, and place on the outside of the enclosure a sign amply indicating that the property was in the possession of the Trust Company, and this proposition had been accepted, and this situation maintained until his bankruptcy, there would, it is believed, be no question that the transaction constituted a valid pledge against the world.

The same conclusion would inevitably follow, if, instead of putting the enclosure and property in the possession of the Trust Company, the parties had selected a special custodian, upon whom should be cast the responsibility of maintaining the custody and possession of the property. A transaction is none the less a pledge because, instead of the pledgee taking possession himself, a custodian does so for him. A transaction is none the less a pledge, because the person, who acts as such custodian *makes a business* of being custodian in such cases. A subsequent ratification being equivalent to a previous authority, the acceptance by the Trust Company of the receipts of the Warehousing Company, when tendered upon the loan, was equivalent to the

Trust Company's ratification of Flanders' selection of the Warehousing Company as custodian. Hence, the transactions were valid as pledges, even if the receipts be not regarded as strictly warehouse receipts. This view was adopted in

Proctor v. *Shotwell,* 79 S. W. Rep., 728,

where the validity of receipts issued under conditions similar to those at bar by a company, of which the present Warehousing Company is the successor, was upheld, the court saying:

"Much has been said by plaintiff to show that the receipt held by interpleader was not what is technically known as a 'warehouse receipt,' and that its transfer to interpleader did not, and could not, transfer possession of the property. It can make no difference in the result which must be reached in this case whether the institution styled 'Merchants & Manufacturers' Warehousing Company of New York' was what would properly be designated a 'warehouseman.' It was in the possession of the grain, and was at least a bailee."

Kentucky Furnace Co. v. *City Bank,* 25 Ky. Law Rep., 28,

(already cited) where the validity of warehouse receipts issued under circumstances similar to those at bar was involved, the court said:

"It is insisted for appellant that the warehouse receipts issued by Holt were not warranted by section 4771, Kentucky Statutes, on the ground that he was not a warehouseman within the meaning of the statute. We do not deem it necessary to decide this point, and no opinion is intimated thereon. The evidence clearly shows that appellee was given a lien on the 113 tons of pig iron in controversy, and that it was set apart and identified beyond question. Holt had charge of it as the agent of the bank. He held it for the bank. It was placed in his possession for this

purpose, and the evidence is undisputed that he informed the bank that he held the iron for it, and the bank instructed him to keep it safely. This was a valid pledge, and the circuit court properly enforced it."

To this position a change of possession is essential.

But it has been shown under the first point that, what was done constituted a sufficient change of possession, and that this was maintained up to the time of the bankruptcy.

It is, therefore, submitted that the second question should be answered in the affirmative.

III.

IF THERE WAS NO PLEDGE, STILL THE TRUST COMPANY ACQUIRED AN EQUITABLE LIEN, THAT IS SUPERIOR TO THE TITLE OF THE TRUSTEE IN BANKRUPTCY.

1. Upon the question, whether an equitable lien existed, the Illinois law is controlling. It is no longer an open question in that state, that the delivery by Flanders of these receipts as security for loans, even if no actual change of possession took place, created equitable liens in favor of the Trust Company. This identical question is settled by

Union Trust Company v. *Trumbull,* 137 Ill., 146,

where the endorsement of similar warehouse receipts, issued by a company doing a business similar to that of the Warehousing Company in this case, did not constitute a valid pledge, because there was no change of

possession, but it was held to create an equitable lien, the court saying (p. 175):

"It is, however, insisted, that even if there was no valid legal pledge of the wool which was in the warehouse at the time of the assignment, yet that, under the circumstances of the case, the holders of the warehouse receipts are entitled to an equitable lien thereon, which, although not recognizable at law, a court of chancery will enforce. * * * These receipts were issued by a duly incorporated storage company, and expressly stated upon their faces that the company had received and was in possession of the number of pounds of 'unwashed wool.' * * * The receipts, upon their faces, indicated that the storage company had complied with the law. * * * The receipt holders were without notice of any fact in derogation of the validity of their receipts. There was an intention and an ineffectual attempt to secure the repayment of the borrowed moneys by creating valid legal pledges. Equity regards that done which ought to be done."

Equitable liens have also been upheld by this court in

Hauselt v. *Harrison*, 105 U. S., 401;
Walker v. *Brown*, 165 U. S., 654.

2. The question, then, is, whether such equitable lien is superior to the title of the trustee in bankruptcy.

It was expressly so held under the bankrupt act of 1841.

Fletcher v. *Morey*, 2 Story, 555; Fed. Cas., 4,864.
Winsor v. *McLellan*, 2 Story, 492; Fed. Cas., 17,887.

Such, also, was the law under the bankrupt act of 1867.

Hauselt v. *Harrison*, 105 U. S., 401.
Yeatman v. *Savings Inst.*, 95 U. S., 764.
Stewart v. *Platt*, 101 U. S., 731.

Does, then, the present bankrupt act intend to change this rule? Its provisions, so far as they have any bearing on this question, are (italics ours):

"Sec. 67. Liens. (a) Claims which for want of record or for other reasons would not have been valid liens as against the claims of the creditors of the bankrupt shall not be liens against his estate. * * *

(d) Liens given or accepted in good faith and not in contemplation of or in fraud upon this act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall not be affected by this act.

(e) That all conveyances, transfers, assignments, or encumbrances of his property, or any part thereof, made or given by a person adjudged a bankrupt under the provisions of this act subsequent to the passage of this act and *within four months prior* to the filing of the petition, with the intent and purpose on his part to hinder, delay or defraud his creditors, or any of them, shall be null and void as against the creditors of such debtor, *except as to purchasers in good faith and for a present fair consideration;* and all property of the debtor conveyed, transferred, assigned, or encumbered *as aforesaid* shall, if he be adjudged a bankrupt, and the same is not exempt from execution and liability for debts by the law of his domicile, be and remain a part of the assets and estate of the bankrupt and shall pass to his said trustee, whose duty it shall be to recover and reclaim the same by legal proceedings or otherwise for the benefit of the creditors. And all conveyances, transfers, or encumbrances of his property made by a debtor at any time *within four months prior* to the filing of the petition against him, and *while insolvent*, which are held null and void as against the creditors of such debtor by the laws of the state, territory, or district in which such property is situate, shall be deemed null and void under this act against the creditors of such debtor if he be adjudged a bankrupt, and such property shall pass to the as-

signee and be by him reclaimed and recovered for the benefit of the creditors of the bankrupt."

"Sec. 70. Title to property. (a) The trustee of the estate of a bankrupt, upon his appointment and qualification, and his successor or successors, if he shall have one or more, upon his or their appointment and qualification, shall in turn be vested by operation of law *with the title of the bankrupt,* as of the date he was adjudged a bankrupt, except in so far as it is to property which is exempt, to all * * * (4) property transferred by him in fraud of his creditors; (5) property which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him. * * *

(e) The trustee may avoid *any* transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, and may recover the property so transferred, or its value, from the person to whom it was transferred, *unless he was a bona fide holder for value* prior to the date of the adjudication. Such property may be recovered or its value collected from whoever may have received it, *except a bona fide holder for value.*"

Considering first these clauses separately—

Clause (a) of Sec. 67, standing by itself, seems to declare that in states, like Illinois, where an equitable lien does not prevail against attachments and executions, it is not enforceable against the bankrupt's estate.

Clause (d) of Sec. 67, standing by itself, makes such an equitable lien superior to the trustee's title. The word "necessary" in this clause is equivalent to "required by the statutes of the state." It declares that liens "accepted in good faith and not in contemplation of, or in fraud upon this act, and for a present consideration," and recorded,—when of a kind

the state law requires to be recorded,—shall be upheld, notwithstanding the other provisions of the bankrupt act. Clearly this clause is not confined to liens that are recordable, or required to be recorded, but applies equally to liens, the recording of which the state law does not contemplate. Otherwise, the phrase "if record thereof was necessary," etc., would be out of place.

Of this character are equitable liens. There is no provision in Illinois for the recording of such liens. Indeed, such a provision would not be feasible, as equitable liens frequently arise out of acts—and sometimes out of acts amounting to estoppels—not reducible to documents, and hence not susceptible of being recorded. As said by Judge Clark of the district of Alabama, in a case hereinafter referred to, in speaking of claims of receipt holders in a case similar to the one at bar:

"The registration of such a claim would not sustain it, and the failure to do so would not defeat it, under the law of the state."

Reading these clauses (a) and (d) together, as they should be, the proper construction is (1) that liens "accepted in good faith," etc., and which are of a nature to be recorded, such as chattel mortgages, are not good against the estate unless recorded; but (2) that liens "accepted in good faith," etc., but not of a nature to be recorded, shall be unaffected by the bankrupt act, although not superior to writs of attachment and execution.

This will be more apparent by considering the subsequent clauses above quoted.

Clause (e) is confined (1) to fraudulent conveyances *within four months* prior to the filing of the petition in bankruptcy, which are made "null and void" by force of the bankrupt act itself, and without reference to any state law, and (2) conveyances *during insolvency* and within said four months, which are by the state law invalid as to creditors. The only relevancy of this clause to the present inquiry is, that it emphasizes the purpose of the bankrupt act to protect "purchasers [and encumbrancers] in good faith and for a present fair consideration."

Clause (a) of Sec. 70 above quoted, defines the *title* which the trustee takes. In strict logical order it should perhaps have preceded the above provisions of Sec. 67. It vests in the trustee *only* "the title of the bankrupt" to the property enumerated in its six numbered paragraphs. Under this clause the title to the leather in controversy vested in the trustee subject, not only to any pledge or mortgage, but this equitable lien; that is, he took the title in the same plight in which the bankrupt held it. That Congress used the words "title of the bankrupt" advisedly and in this sense, seems apparent from the fact that, under former bankrupt acts, this court had uniformly held that the assignee in bankruptcy took subject to liens and equities—that is, in the same plight in which the bankrupt held—and that the only further right the assignee took was the right, not of the bankrupt, but of his creditors, to avoid fraudulent conveyances.

But it is suggested that subdivision (4) of this clause shows that something more than the title of the bankrupt is here contemplated, because a bankrupt has him-

self no title to property fraudulently transferred by him. But this is not always true. If a fraudulent transfer is other than an absolute one, the bankrupt still has title subject to the encumbrance.

Again it is said that this clause is not to be confined to the title of the bankrupt, because subdivision (5) thereof refers to property which might have been sold under judicial process, and, under the Illinois law, this leather might have been levied upon and sold free from the equitable lien.

This view can only prevail by nullifying the controlling words, "title of the bankrupt"; but, in construing a statute, all words are, if possible, to be given effect. Phrases, like subdivision (5), which are general in their terms and made broad, by way of caution, should not, in construction, be allowed to lessen definite clauses like "title of the bankrupt."

But any reasonable doubt as to the intention of Congress disappears when clause (e) of Sec. 70, above quoted, is considered. It is this clause, and not subdivision (4) of clause (a), Sec. 70, that confers upon the trustee the right to avoid fraudulent conveyances made more than four months before the proceedings in bankruptcy. It confers upon the trustee the right to avoid any transfer—whether absolute or by way of security—of the bankrupt, which any of his creditors might, under the state law, have avoided, *provided* the person, against whom recovery is sought, is not "a *bona fide* holder for value." It emphasizes, what is also apparent in clause (e) of Sec. 67, that the intention of the bankrupt act is to preserve the rights of innocent persons. Considered by itself, this clause clearly

preserves the right of persons—such as appellants are —who innocently and for a present consideration, have acquired equitable liens upon the property of the bankrupt.

Considered in connection with the other clauses, the result is the same. This clause (e) must, being the latest, be deemed to impose a limitation, in favor of innocent holders for value, upon any right conferred upon the trustee by any prior provision of the act. Hence it is a limitation or qualification of clause (a) of Sec. 67. This is well expressed by Judge Clark in an unpublished opinion, in a case involving the validity of warehouse receipts issued by this same Warehousing Company.

"It seems open to the trustee, under the above statute, to follow the property fraudulently conveyed, or the proceeds of such property, into the hands of whoever may have received it, until a *bona fide* purchaser is reached, and that the statute makes this a limit, beyond which the trustee may not go. * * * The creditor's right is passed to and vested in the trustee by operation of the bankruptcy law subject to the limitation that the right of a *bona fide* purchaser or holder must not be disturbed or divested.

The purpose to guard the right of a *bona fide* purchaser or holder is everywhere manifested on the face of the Bankruptcy Act, as amended by the act of 1903.

This protection of the right of a *bona fide* purchaser is necessary in order to uphold sound commercial policy and confidence, and to avoid inflicting upon the innocent the unnecessary and harsh disadvantage of frequent and serious loss."

As a result of construing together, and giving effect to, all the provisions above quoted, the following propositions seem to state the intention of Congress:

1. The trustee is first vested with the *title of the*

bankrupt to all property fraudulently conveyed, and to all property the latter could have transferred, or which might have been sold under legal process against him; that is, *with the estate of the bankrupt in the same plight, in which the bankrupt held it.*

2. The trustee is also invested with the right to avoid all liens that are invalid against creditors, except those taken in good faith and not in contravention of, or in fraud under, this act, and for a present consideration, and—when required by the state law to be—recorded. This is without regard to what the state law is.

3. The trustee is further invested (independent of any state statute) with the right to avoid conveyances in fraud of creditors made within four months of the bankruptcy proceedings, except as against purchasers in good faith and for a present consideration. He may also avoid such transfers, made *during insolvency* and within said four months, as are invalid against creditors by the state law.

4. The trustee is invested with the power, beyond the four months, to avoid *any* transfer, whether absolute or by way of security, which, under the state law, any creditor of the bankrupt might have avoided, *provided this does not involve a recovery from, or encroachment upon, the right of a bona fide purchaser or holder for value.* This protection to a *bona fide* holder is a limitation imposed by the bankrupt statute, and exists, although not in the state law. In other words, an equitable lien in favor of an innocent holder is superior to the title of the trustee, although under

the state law, as in Illinois, it might have been avoided by creditors.

The reason for this is emphasized by the facts recited in the certificate. The receipts taken by the Trust Company as security for these loans, recite that the property therein described is *in the possession* of the Warehousing Company. If this was not the fact, the bankrupt is chargeable with knowledge of it. The Trust Company is not, because the certificate recites that these loans were made, and receipts taken, in the regular course of its business. When, therefore, Flanders tendered the receipts and obtained money thereon, he was guilty of a legal fraud upon the Trust Company, if the Warehousing Company was not in possession. He obtained, by representing a fact which did not exist, money from the Trust Company, which, unlike Flanders, was in ignorance of the truth. This should estop this bankrupt from claiming that these receipts were not valid pledges. The question is, whether an estoppel, binding upon the bankrupt, also binds his trustee in bankruptcy. If not, then trustees and creditors are, by the bankrupt act, permitted to profit by the misconduct or fraud of the bankrupt. *Should such an intention be imputed to Congress?* If such were the intention, would not so radical a departure from the previous bankrupt acts have been more clearly expressed?

The following cases hold the trustee in bankruptcy under the present act is estopped, when the bankrupt is:

In re Standard Laundry Co., 116 Fed., 476; 53 C. C. A., 644.

Pennington v. *Hunt*, 20 Fed., 195.

In *First National Bank* v. *Penn. Trust Co.*, 124 Fed., 968, 60 C. C. A., 100 (heretofore cited under Point I), where there had been a setting aside of iron by way of pledge, accompanied by signs placed thereon indicating the pledge, which, however, had, without the knowledge of the pledgee, been removed by the pledgor before bankruptcy proceedings, the Circuit Court of Appeals of the Third Circuit decided that the trustee took subject to the lien of the creditor, saying:

"The transaction was one made in the ordinary course of business, without fraud either in fact or in law; it was for a present valuable consideration, and completed more than four months before the adjudication of bankruptcy. * * * It may be that an innocent purchaser for value, or a judgment creditor without notice, might, by execution and levy, have acquired a prior lien; but surely, as against the pledgor, the bank's lien remained, notwithstanding the removal of the signs. Neither the general creditors nor the receiver of the bankrupt could acquire any better title to any property of the bankrupt than the bankrupt himself had at the time of filing the petition in bankruptcy, and therefore the lien was good as against them. The receiver in bankruptcy, standing in the place of the trustee, takes the property in question 'as a purchaser from the bankrupt, with notice of all outstanding rights and equities.' Whatever the bankrupt might do to make the property available to the general creditors, he may do nothing more, except that he may sue for and recover that which was conveyed in fraud of creditors."

It is difficult to distinguish this case, as respects the question under consideration, from the one at bar. In each case the bank made a loan in the regular course of its business, and in doing so relied upon a change of possession, and was not chargeable with any knowledge that it did not exist. In each case,

by the state law, an attachment or execution writ would have prevailed over the creditor's lien. Thus, as respects the present question, this case seems on all fours with the case presented by this certificate.

No other case under the present act has been found, in which the precise question here presented has been squarely decided.

In *In re Rodgers,* 125 Fed., 169, 60 C. C. A., 567 (now on the docket of this court as No. 139), the same Circuit Court of Appeals, from which the present certificate comes, in effect decided, in a case in this respect like the one at bar, that the title of the trustee was superior to the equitable lien. That court did not, however, make a distinction—which clearly exists—between a fraudulent conveyance—to avoid which both parties must have participated in the fraudulent intent—and an equitable lien in which, as at bar, the creditor is not a participant in any legal or actual wrong doing. The subsequent certifying of this question to this court indicates that this Circuit Court of Appeals now entertains doubts upon the correctness of its decision in *In re Rodgers, supra.*

There is, however, a pronounced conflict in the views of the lower courts respecting the construction of the above provisions of the bankrupt act, as applied to somewhat kindred questions, arising upon unrecorded chattel mortgages, fraudulent conveyances, etc. It is not the purpose of this brief to review these cases in detail. A number of them are here listed.

In re Economical Printing Co., 110 Fed., 514, 49 C. C. A., 133.

There the Circuit Court of Appeals of the Second Circuit held that a chattel mortgage—which has ceased to be valid as against the mortgagor's creditors or purchasers, because not refiled within a year, as required by the New York statute—superior to the title of the bankrupt's trustee, although an attachment or execution writ would have been superior to such lien.

The same court announced the same rule in

In re Garcewich, 115 Fed., 87, 53 C. C. A., 510,

as follows (p. 89):

"Under the present bankrupt act, as under previous bankrupt acts, the trustee takes the property of the bankrupt, in cases unaffected by fraud, in the same plight and condition that the bankrupt himself held it, and subject to all the equities impressed upon it in the hands of the bankrupt, except in cases where there has been a conveyance or incumbrance of the property which is void as against the trustee by some positive provision of the act."

In

Hewit v. *Berlin Machine Wks.,* 194 U. S., 296,

this court seems to cite with approval the first of the above cases, and as pertinent, a like decision by Judge Story under a prior bankrupt act.

In re Standard Laundry Co., 116 Fed., 476; 53 C. C. A., 644.

There the Circuit Court of Appeals of the Ninth Circuit held that, when a bankrupt had bought property by bill of sale, *subject* to a chattel mortgage which he assumed to pay, a valid lien was thereby created as against the trustee in bankruptcy, although the mortgage was void as to creditors because not executed

in accordance with the California chattel mortgage statute. The court said:

"By the terms of its purchase of the property it is estopped from denying the validity of the mortgage or of its own obligation to Muller. In a case of this character the trustee, representing the creditors, stands in the shoes of the laundry company, and is in privity with it, so far as the title of the property is concerned. He has the same rights that the laundry company has; no more. As the bankrupt is estopped from denying the validity of the mortgage, so is the trustee."

And after reviewing the cases, the court held that the attitude of the trustee in this respect does not differ from that of the assignee under the former act.

In re Chase, 124 Fed., 753; 59 C. C. A., 631.

There the Circuit Court of Appeals of the First Circuit in allowing an assignee, under a voluntary assignment, for the benefit of creditors, priority for his disbursements and compensation incurred and rendered prior to bankruptcy proceedings, held that the trustee in bankruptcy had no equities greater than those of the bankrupt.

In

Chattanooga Bank v. *Rome Iron Co.,* 102 Fed., 755,

a lien upon an equity in property, which had been placed in storage, was, by the District Court of Georgia, held superior to the trustee's title.

In

In re Josephson, 116 Fed., 404,

Judge Speer held that a trustee in bankruptcy took subject to the lien of an unrecorded chattel mortgage, saying:

"This is a contest between equities. * * * It is quite clear that no court of the United States would be justified in concluding that congress intended to change with radical purpose the property laws of a state unless that purpose can be gathered from explicit and unequivocal terms of the act of congress. * * * * It also may be said that if congress should, by sweeping enactments, declare that every lien, by means of which the commercial and agricultural people in many states of the Union obtain credit, should necessarily be placed upon record, in view of their slender means it would practically destroy their capacity to take part either in commerce or in manufacture or to carry on their agricultural operations successfully. This is true particularly of the Southern states. The legislature of each state clearly understands the necessity of its own people. The legislature has the right to determine whether it is best to have these liens recorded."

In re Hinsdale, 111 Fed., 502, and
In re Sewell, 111 Fed., 791,

uphold conditional sales as against the trustee in bankruptcy, although not, under the state law, valid against attaching creditors.

Other cases assert the superiority of the trustee's title to unrecorded chattel mortgages, etc.

Chesapeake Shoe Co. v. *Seldner*, 122 Fed., 593, C. C. A. (4th Cir.) (conditional sale).

In re Pekin Plow Co., 112 Fed., 308, C. C. A. (8th Cir.) (unrecorded chattel mortgage).

In re Butterwich, 131 Fed., 371 (conditional sale).

In re Thorp, 130 Fed., 371 (unrecorded mortgage).

It is therefore submitted that the law is with the

Union Trust Company and the Security Warehousing Company upon the three questions certified.

Respectfully submitted,

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